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IN THE

Supreme Court of the United States

CALPINE ENERGY SERVICES, L.P.,
AMERICAN ELECTRIC POWER SERVICE CORP.
AND
ALLEGHENY ENERGY SUPPLY CO., LLC,
Petitioners,

v.

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY
WASHINGTON, *et al.*, and
FEDERAL ENERGY REGULATORY COMMISSION,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

The Federal Power Act ("FPA"), 16 U.S.C. §§ 791a *et seq.*, sets forth the standards by which the Federal Energy Regulatory Commission ("FERC") regulates wholesale energy rates. In *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956), and *Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956), this Court determined that, under the FPA, FERC may undo a valid wholesale energy contract only in the extraordinary circumstance when the contract is contrary to the public interest. In conflict with *Mobile* and *Sierra*, and with decisions of the D.C. and First Circuits, the Ninth Circuit in the decision below held that FERC may nullify voluntary wholesale energy contracts—absent the requisite showing of public necessity—if FERC determines in hindsight that the negotiated rate is unreasonable or that, absent the challenged contracts, retail rates for energy would be slightly lower. Thus, this petition presents the following questions:

1. Whether the Ninth Circuit misapplied this Court's holdings in *Mobile* and *Sierra* and created conflicts with the D.C. and First Circuits when it reversed FERC's decision to uphold valid wholesale energy contracts absent any showing that the public interest required their abrogation.

2. Whether the Ninth Circuit misapplied the *Mobile-Sierra* doctrine by determining that the *Mobile-Sierra* public interest criteria apply only to sellers, but not to buyers, under wholesale power contracts, in direct conflict with *Mobile*, *Sierra*, and the decisions of other circuits.

PARTIES TO THE PROCEEDING

Petitioners Calpine Energy Services, L.P., Allegheny Energy Supply Co., LLC and American Electric Power Service Corp. intervened in the court of appeals. Other intervenors included BP Energy Co., El Paso Merchant Energy L.P., Mirant Americas Energy Marketing (now Mirant Energy Trading LLC) and Morgan Stanley Capital Group.

Respondents Nevada Power Company and Sierra Pacific Power Company were petitioners below.

Respondent Federal Energy Regulatory Commission was the respondent below and is the respondent here "by rule." *See* SUP. CT. RULE 12.6.

The court of appeals' decision resolved five other separate petitions for review. The petitioners were Public Utility District No. 1 of Snohomish County Washington, Southern California Water Company, the Attorney General, State of Nevada, Nevada Power Company and Sierra Pacific Power Company. Reliant Energy Services Inc. intervened in the Snohomish matter, and Enron Power Marketing Inc. intervened in the Southern California Water Company matter. The Federal Energy Regulatory Commission was the respondent to all of the petitions.

In a related decision issued on the same day by the same panel, the court below resolved two additional petitions for review. Petitioners were the California Electric Oversight Board, the California Public Utilities Commission, and the Public Utilities Commission of the State of California. In addition to several of the entities listed above, intervenors included Pacific Gas and Electric Company, Nevada Power Company, Southern California Edison Co., Department of Water and Power of the City of Los Angeles, Public Service Department of the City of Burbank, Public Service Department of the City of Glendale, Water and Power Department of the City of Pasadena, Sempra Energy, Coral

Power, L.L.C., PPM Energy, Inc., and Dynegy Power Marketing, Inc. The Federal Energy Regulatory Commission was the respondent to both petitions.

CORPORATE DISCLOSURE STATEMENT

Calpine Energy Services, L.P. states that it is a Delaware limited partnership with its principal place of business in Houston, Texas. Calpine Energy Services, L.P. is an indirect, wholly owned subsidiary of Calpine Corporation, a Delaware corporation whose common stock is traded on the Pink Sheets and whose principal places of business are located in San Jose, California and Houston, Texas. No publicly held company owns more than 10 percent of Calpine Corporation's stock.

American Electric Power Service Corp. states that it is a subsidiary of American Electric Power Company, Inc., a New York corporation whose common stock is held by the public and traded on the New York Stock Exchange and whose principal place of business is located at 1 Riverside Plaza, Columbus, Ohio 43215. American Electric Power Company, Inc. has no parent company, and no publicly held company has a 10 percent or greater ownership interest in American Electric Power Company, Inc.

Allegheny Energy Supply Co., LLC states that it is a Delaware limited liability company with its principal place of business in Greensburg, Pennsylvania. Allegheny Energy Supply Co., LLC is a direct subsidiary of Allegheny Energy, Inc., a registered holding company under the Public Utility Holding Company Act of 2005. There are no companies that own a 10 percent or greater interest in Allegheny Energy, Inc.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners seek a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit.

DECISION BELOW

The opinion of the United States Court of Appeals for the Ninth Circuit is reported at 471 F.3d 1053 and is reprinted in the Appendix to the Petition (Pet. App.) at 1a. The related decision is reported at 474 F.3d 587. Pet. App. 364a. The decision of the Administrative Law Judge is reported at 101 FERC ¶ 63,031. Pet. App. 68a. The orders of the Federal Energy Regulatory Commission are reported at 103 FERC ¶ 61,353, Pet. App. 246a, and 105 FERC ¶ 61,185. Pet. App. 314a.

JURISDICTION

The judgment of the United States Court of Appeals for the Ninth Circuit was entered on December 19, 2006. No petition for en banc review was filed. On March 8, 2007, Justice Kennedy signed an order extending the time for filing the petition for certiorari to and including May 3, 2007. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS

The relevant provisions of the Federal Power Act, 16 U.S.C. §§ 791a *et seq.*, are reproduced in the Appendix to the Petition (Pet. App. 381a-395a).

STATEMENT

A. Statutory Background

Sections 205 and 206 of the Federal Power Act ("FPA") set forth the standards by which the Federal Energy Regulatory Commission ("FERC") regulates rates for wholesale electricity sales. Section 205 requires that all such rates "be just and reasonable," and provides that any rate that is not just and reasonable is unlawful. 16 U.S.C. § 824d(a).

Section 206 provides that, if FERC finds that a wholesale energy rate is "unjust, unreasonable, unduly discriminatory or preferential," FERC "shall determine the just and reasonable rate" and "shall fix the same by order." *Id.* § 824e(a).

This Court has expressly held that, under the FPA, FERC has only limited power to modify valid wholesale power sales contracts. In 1956, this Court issued two unanimous decisions holding that the FPA and the Natural Gas Act require wholesale contracts to be enforced except in extraordinary circumstances of unequivocal public necessity. *See United Gas Pipe Line Co. v. Mobile Gas Serv. Co.*, 350 U.S. 332, 344 (1956) ("*Mobile*"); *Fed. Power Comm'n v. Sierra Pac. Power Co.*, 350 U.S. 348, 354 (1956) ("*Sierra*"). For more than fifty years, this "*Mobile-Sierra* doctrine" has protected the stability and enforceability of valid contracts. Relying on *Mobile* and *Sierra*, market participants such as Petitioners have made massive, long-term purchase and investment decisions to fulfill their contractual commitments.

B. The Complaints By The Nevada Power Companies

Between November 2000 and June 2001, Nevada Power Company and Sierra Pacific Power Company (together, the "Nevada Companies") embarked on an aggressive power purchasing strategy. Pet. App. 297a. The Nevada Companies solicited offers from wholesale power suppliers by using a third-party broker to arrange transactions. *Id.* The Nevada Companies received offers from many suppliers, and executed more than two hundred contracts obligating them to buy electric energy at fixed prices for delivery during specific months and hours of 2002, 2003, and 2004. During this period, Nevada Power purchased power from thirty-nine different wholesale suppliers, and Sierra Pacific purchased power from forty-five suppliers. Pet. App. 298a. Petitioners

were among those that contracted to sell power to the Nevada Companies.

These sales were made at prices at or below then-prevailing market levels for sales of electricity to be delivered in the future ("forward contracts"). With the opportunity to choose among many offers, including offers for lower prices than they accepted, or even to defer contracting until times closer to delivery, the Nevada Companies elected to enter into forward contracts at prices that they deemed acceptable. Pet. App. 297a-298a. Petitioners made corresponding physical or financial commitments for the production or purchase of electricity to ensure that they could meet their supply commitments.

The Nevada Companies intentionally purchased substantially more power than they needed to serve their own local load obligations. Pet. App. 297a. In 2000, the Nevada Companies sold excess power and realized a margin of $100 million. Pet. App. 154a. Nevada Power's revenues from resale increased eight-fold from 1999 to 2000, and 6.7 times from 2000 to 2001. *Id.* Sierra's revenues from resale increased five-fold from 1999 to 2000, and more than doubled from 2000 to 2001. *Id.* At one point, the Nevada Companies' portfolio indicated prospective financial profits of as much as $1.8 billion. Pet. App. 154a-155a. During 2001, the Nevada Companies continued to purchase more power than needed for their retail needs. Pet. App. 297a.

When wholesale energy prices declined, however, the Nevada Companies sought to escape their contractual obligations. In December 2001, the Nevada Companies filed complaints under Section 206 of the FPA asking FERC to reduce the contract prices for electricity to be delivered in 2002-2004. The Nevada Companies suddenly complained that they had agreed to pay prices that were not "just and reasonable."

Petitioners' contracts to supply the Nevada Companies did not impose an excessive burden on them or on their retail customers. Indeed, the Nevada Companies' retail rates *decreased* after they agreed to enter into the challenged contracts. Pet. App. 31a.

C. FERC's Decision

FERC set the Nevada Companies' complaints for hearing pursuant to Section 206 of the FPA. The Nevada Companies' cases were consolidated with complaints filed by the Public Utility District No. 1 of Snohomish County and Southern California Water Company concerning power purchases from other sellers.

After extensive hearings, FERC held that the *Mobile-Sierra* doctrine governed the complainants' attempts to modify the forward contracts at issue. FERC ruled that the complainants failed to prove that the "public interest" required contract modifications. Pet. App. 292a-293a. Applying the three prongs of the public interest test required by *Mobile* and *Sierra*, FERC found that the complainants had failed to show that the challenged contracts would (1) impair their financial ability to continue their business, because the Nevada Companies would remain profitable under the challenged agreements; (2) cast on other consumers an excessive burden, because energy costs incurred by the Nevada Companies would not necessarily be passed through to retail rates (which would, in any event, decrease going forward); or (3) be unduly discriminatory. Pet. App. 293a-296a.

FERC also considered the "totality of circumstances" surrounding the formation of the challenged contracts. Pet. App. 319a. FERC concluded that none of the contracts had resulted from "market power" or from "fraud, duress, or bad faith between the parties at the contract formation stage." Pet. App. 345a. FERC found that the Nevada Companies had many options as buyers: "The availability of other

alternatives and the Complainants' buying practices are indicative of circumstances under which the transactions in question were executed. The availability of more competitively priced products demonstrates that the Complainants were not induced to enter into the transactions at issue. They were free to reject offers that led to execution of the contracts in question, and turn to other suppliers." Pet. App. 339a-340a. FERC held that the complainants failed to show "market manipulation that specifically affected the contracts at issue" or to show that "dysfunctions" in the California spot market warranted excusing the complainants from their voluntary contracting decisions. Pet. App. 341a.

D. The Ninth Circuit's Decision

The Nevada Companies and other purchasers petitioned for review in the Court of Appeals for the Ninth Circuit.

The Ninth Circuit (Browning, Pregerson, Berzon, JJ.) stated that, in their view, *Mobile* and *Sierra* should be limited to their facts. Pet. App. 7a (*Mobile* and *Sierra* apply when a complaint challenges that a utility's rates "are too low to be just and reasonable," and apply "in certain circumstances"; these decisions explain how wholesale contract rates should be evaluated "in the context of the energy industry as it existed in 1956"). While stating that the *Mobile-Sierra* doctrine is not a "dead letter," the Ninth Circuit invented two prerequisites for the doctrine to apply in this case. Pet. App. 10a.

First, the regulatory scheme in which the contracts are formed must provide FERC with the "opportunity for effective, timely review" of the contract rates. Pet. App. 10a. To satisfy this prerequisite, FERC must, before applying the *Mobile-Sierra* doctrine, determine that the rates in the challenged contracts were "in fact 'just and reasonable,'" and must undertake an "inquiry into the actual

state of the market at the time the contracts were negotiated." Pet. App. 51a.

Second, if FERC relies on a market-based rate-setting system, the required "just and reasonable" review "must permit consideration of all factors relevant to the propriety of the contract's formation." Pet. App. 10a. In the Ninth Circuit's view, *Mobile-Sierra* "cannot apply without a determination that the challenged contract was initially formed free from the influence of improper factors, such as market manipulation, the leverage of market power, or an otherwise dysfunctional market." Pet. App. 57a. The court acknowledged that FERC found no evidence of unfairness, bad faith, or duress during negotiation of the challenged contracts, and found that the buyers entered into the contracts voluntarily. Pet. App. 59a. But, according to the court, the critical issue is the market "*context*, not the conduct" of the parties during negotiations of the challenged contracts. *Id.* (emphasis in original).

The Ninth Circuit acknowledged that the parties to the challenged contracts intended to create fixed obligations subject only to *Mobile-Sierra* review. Pet. App. 44a-45a. Nevertheless, the Ninth Circuit refused to honor that intent because FERC had not satisfied the court's newfound preconditions for applying the *Mobile-Sierra* doctrine.

The Ninth Circuit further limited the *Mobile-Sierra* doctrine by concluding that the "public interest" factors set forth by this Court apply only to a "low-rate challenge" such as the challenge at issue in *Sierra*. Pet. App. 61a-62a. In the Ninth Circuit's view, the "proper standard for the *Mobile-Sierra* 'public interest' mode of review in a high-rate challenge is not whether the contracted rates pose an 'excessive burden' on consumers, but whether the wholesale energy contract is outside the 'zone of reasonableness'" and results in retail rates higher than would be the case if that zone were not exceeded." Pet. App. 64a-65a.

Finally, the Ninth Circuit mistakenly stated that the Nevada Companies were "price-takers, meaning that those utilities took the price the market yielded rather than bargaining or demanding certain prices." Pet. App. 30a. FERC had found just the opposite, *i.e.*, that "Respondents" (the power sellers, Petitioners here) were price takers. Pet. App. 160a, 297a. Thus, it is the Petitioners here that "took the price the market yielded rather than bargaining or demanding certain prices." The Ninth Circuit expressly recognized that "Nevada Power's retail rates decreased after the challenged contracts were negotiated," but found that "slightly lower rates" might still affect the public interest if, absent the challenged contracts, retail rates would have been even lower. Pet App. 66a.

REASONS FOR GRANTING THE PETITION

In the decision below, the Ninth Circuit rejected the regulatory regime established by the FPA and this Court's decisions in *Mobile* and *Sierra*. This Court should grant review of this remarkable decision for three reasons.

First, the Ninth Circuit's decision conflicts with this Court's decisions and the decisions of other courts of appeals. The decision is flatly inconsistent with *Mobile* and *Sierra* because it permits the abrogation of energy contracts where there is no harm to the public interest. It also conflicts with decisions of the D.C. and First Circuits because it requires plenary review of each and every energy contract before the *Mobile-Sierra* "public interest" standard applies.

Second, the Ninth Circuit's decision will undermine and create uncertainty in the national energy markets. The rejection of the current regulatory regime and the repudiation of valid contracts executed by sophisticated entities make it impossible for a seller to predict whether a valid contract will be modified by the Government during the contract's term. This uncertainty is exacerbated by the reach of the

Ninth Circuit's new rules, which call into question contracts by sellers that were "price takers" in favor of sophisticated buyers, even though ultimate consumers still experienced a rate *decrease* while the challenged contracts were in effect. The decision also will hamper the ability of electricity markets to avoid or respond to the next energy crisis.

Third, the Ninth Circuit's decision is erroneous and misguided. This Court in *Mobile* and *Sierra* and the D.C. and First Circuits have correctly reasoned that the opportunity for plenary review of a contract by FERC is not a prerequisite to the "public interest" analysis. Moreover, the Ninth Circuit's unprecedented standard results in disparate treatment of contract challenges brought by sellers and those brought by buyers.

I. THE DECISION BELOW CONFLICTS WITH THIS COURT'S DECISIONS IN *MOBILE* AND *SIERRA* AND WITH DECISIONS OF THE D.C. AND FIRST CIRCUITS

The Ninth Circuit's decision contravenes *Mobile* and *Sierra*, in which this Court recognized that FERC may undo a valid wholesale energy contract only in the rare instance when the contract harms the public interest. The decision below also conflicts with decisions of the D.C. and First Circuits, which have held that the "public interest" standard mandated by *Mobile* and *Sierra* applies regardless of whether the contract has previously been subject to plenary review by FERC, and whether the party seeking to set aside the agreement is a seller that claims that the contract rate is too low or a buyer that claims that the rate is too high. For over fifty years, the *Mobile-Sierra* doctrine has secured expectations regarding the stability of contracts between sophisticated buyers and sellers in the energy markets. The conflict created by the decision in this important area of law warrants this Court's immediate review.

A. The Decision Below Conflicts With *Mobile* And *Sierra*

The Ninth Circuit's decision eviscerates the *Mobile-Sierra* doctrine. In *Mobile*, this Court unanimously held that an energy company cannot unilaterally change wholesale energy rates set by contract merely by filing a new rate with FERC pursuant to the "'filed-rate' procedure" of the Natural Gas Act. 350 U.S. at 337, 340-41. The Court stressed that the Act (which is materially identical to the Federal Power Act, *see Sierra*, 350 U.S. at 353) "expressly recognizes that rates to particular customers may be set by individual contracts," and that the statute "evinces no purpose to abrogate" such "private rate contracts." *Mobile*, 350 U.S. at 338. Thus, market participants may choose "to fix by contract, and change only by mutual agreement, the rate agreed upon with a particular customer." *Id.* at 343. To be sure, the Court explained that "all rates are subject to being modified by the Commission upon a finding that they are unlawful." *Id.* at 341. But FERC's limited authority to modify privately negotiated rates is "neither a 'rate-making' nor a 'rate-changing' procedure," and may be invoked only when it is "necessary in the public interest." *Id.* at 341, 344.

In *Sierra*, this Court elaborated on FERC's limited role in regulating energy rates set by contract. *Sierra* addressed whether, under Section 206 of the Federal Power Act, Pet. App. 381a-395a, FERC can declare a contract "'unjust' or 'unreasonable' simply because it is unprofitable to the public utility." 350 U.S. at 355. Again emphasizing the sanctity of freely negotiated contracts, this Court explained that while FERC "may not normally impose upon a public utility a rate which would produce less than a fair return, it does not follow that the public utility may not itself agree by contract to a rate affording less than a fair return or that, if it does so, it is entitled to be relieved of its improvident bargain." *Id.* Indeed, "it is clear that a contract may not be said to be either 'unjust' or 'unreasonable'" within the meaning of the

Act simply because it turns out, in hindsight, to be "unprofitable" to one of the contracting parties. *Id.* Rather, FERC may invalidate a long-term wholesale energy contract only in the rare instance when the rate "adversely affect[s] the public interest—as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory." *Id.*

In subsequent cases, this Court has repeatedly reaffirmed the *Mobile-Sierra* doctrine that FERC may modify rates set by a valid wholesale energy contract only when required by *Sierra's* three-prong public interest standard. *See, e.g., Ark. La. Gas Co. v. Hall*, 453 U.S. 571, 582 (1981) ("[T]he Commission itself lacks affirmative authority, absent extraordinary circumstances, to 'abrogate existing contractual arrangements.'") (quoting *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 820 (1968)); *see also Verizon Commc'ns, Inc. v. FCC*, 535 U.S. 467, 479-80 (2002) (quoting *Sierra* and explaining that FERC may not undo a wholesale energy contract merely because of an "improvident bargain").

The decision below contravenes this Court's precedents. The Ninth Circuit concluded that the *Mobile-Sierra* doctrine is obsolete, if not yet a "dead letter," and that it applies only in "certain limited circumstances." Pet. App. 10a, 36a. In so holding, the Ninth Circuit ignored this Court's strong admonition that the lower courts are to leave to this Court the task of revising its clear precedent. *See, e.g., State Oil Co. v. Khan*, 522 U.S. 3, 20 (1997). Moreover, the Ninth Circuit held that even if the *Mobile-Sierra* doctrine applied to the contracts at issue here, the proper standard for FERC to apply in determining whether to modify the contracts "is not whether the contracted rates impose an 'excessive burden' on consumers," as this Court has insisted, *see Sierra*, 350 U.S. at 355, "but whether the wholesale energy contract is outside the 'zone of reasonableness . . . .'" Pet.

App. 65a. The Ninth Circuit's decision is flatly at odds with *Mobile*, *Sierra*, and their progeny, which set forth the fundamental tenet that FERC may set aside an otherwise valid agreement only in "extraordinary circumstances" of "unequivocal public necessity," *Permian Basin Area Rate Cases*, 390 U.S. at 820, 822; *Ark. La. Gas Co.*, 453 U.S. at 582, and not merely because a contracting party, in hindsight, claims that it made an improvident bargain, *see Sierra*, 350 U.S. at 355.

B. The Decision Below Conflicts With Decisions Of The D.C. And First Circuits

The Ninth Circuit's construction of the *Mobile-Sierra* doctrine poses a direct conflict with decisions of the D.C. and First Circuits, both of which have rejected the Ninth Circuit's view that (1) initial agency review of a contract is a prerequisite to application of the *Mobile-Sierra* public interest standard, Pet. App. 39a; and (2) the public interest standard does not apply when a buyer asks FERC to reduce a rate that it claims is higher than the just and reasonable level, Pet. App. 63a-64a. The obvious risk that the same contract would receive disparate treatment, depending solely on the circuit to which the case is brought, warrants this Court's immediate review.

1. The Ninth Circuit held that the *Mobile-Sierra* doctrine applies only after FERC has had a chance to conduct a "plenary, 'just and reasonable' agency review" of the contract. Pet. App. 41a. That holding creates a circuit split with the First and D.C. Circuits, which have held that a prior "just and reasonable" review of a contract is *not* a prerequisite to application of the *Mobile-Sierra* "public interest" standard.

In *Northeast Utilities Service Co. v. FERC*, 993 F.2d 937 (1st Cir. 1993), the First Circuit vacated FERC's order modifying contracts that the Commission was reviewing for the first time. FERC modified the rates set by the contracts

on the ground that they were "unjust and unreasonable." *Id.* at 960. In rejecting FERC's use of the "just and reasonable" standard, the First Circuit held that FERC "was bound to follow the *Mobile-Sierra* doctrine" even though the Commission had not had a prior opportunity to review the agreements for reasonableness. *Id.* at 962. Accordingly, it instructed FERC to reevaluate the contracts under the "public interest" standard on remand. *Id.*

Likewise, in *Borough of Landsdale v. Federal Power Commission*, 494 F.2d 1104 (D.C. Cir. 1974), the D.C. Circuit held that the *Mobile-Sierra* doctrine applied even though the contract at issue "ha[d] never been filed with, or accepted by, the Commission." *Id.* at 1114. To be sure, the Ninth Circuit in the decision below attempted to minimize the circuit split that it created by characterizing *Landsdale* as a case that "primarily reflected concern over a *seller's* abuse of the rate-filing requirement." Pet. App. 40a (emphasis added). But the D.C. Circuit's holding is not so narrow. That court rejected the argument that filing a contract with FERC is a prerequisite for the public interest standard to apply because such a result would "stand[] the *Sierra-Mobile* doctrine on its head." 494 F.2d at 1113. Indeed, the D.C. Circuit subsequently confirmed that this rationale "is equally applicable" where a seller "seek[s] to enforce, rather than to abrogate, [an] unfiled contract." *Compania de Gas de Nuevo Laredo, S.A. v. FERC*, 606 F.2d 1024, 1029 (D.C. Cir. 1979).

Moreover, the D.C. Circuit has held that FERC's market-based rate framework—*i.e.*, the system whereby wholesale sellers that demonstrate that they lack market power are free to negotiate rates—satisfies the requirement in Section 205 of the Act that contract rates be "just and reasonable." *See, e.g., Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870-71 (D.C. Cir. 1993). Thus, even if an initial determination that rates are "just and reasonable" were somehow a prerequisite to application of the *Mobile-Sierra* doctrine, no

individualized review of contracts by FERC would be necessary under D.C. Circuit law. The Ninth Circuit has created a square conflict among the circuits by requiring further review by FERC under the "just and reasonable" standard before reaching the *Mobile-Sierra* "public interest" test.

2. The Ninth Circuit also held that *Mobile* and *Sierra*, even if applicable to the contracts at issue here, permit FERC to reform the contracts if the negotiated rates, in hindsight, turn out to be "outside the 'zone of reasonableness.'" Pet. App. 65a. The court below reasoned that the factors set forth by the Supreme Court for evaluating a seller's challenge to contract rates do not apply to a challenge brought by a buyer. Pet. App. 63a-64a. The Ninth Circuit's holding that the enforceability of a contract should be analyzed under different standards depending on whether the agreed-upon rates are alleged to be too high or too low conflicts with the decisions of other courts of appeals.

The First and D.C. Circuits have held that the *Mobile-Sierra* public interest standard governs FERC's review of contracts regardless of whether the party challenging the contract claims that the rate is higher or lower than the just and reasonable level. *See Boston Edison Co. v. FERC*, 233 F.3d 60, 68 (1st Cir. 2000) (vacating an order reducing a rate charged by the seller where, although "the rates [were] too high . . . to be just and reasonable," FERC "never found that the higher rates . . . were contrary to the public interest"); *Potomac Elec. Power Co. v. FERC*, 210 F.3d 403, 409 (D.C. Cir. 2000) (affirming FERC's refusal to reduce contractual rates because the complainant "fail[ed] to provide any evidence of undue discrimination or excessive burden, other than the disparity in rates and a bald claim that [the complainant's] ratepayers would derive benefit from a rate modification"). In applying the *Mobile-Sierra* public interest standard to reject a buyer's effort to reduce rates agreed to by contract, the D.C. Circuit stressed the strong

policy in favor of "contractual stability" and explained that "the fact that a contract has become uneconomic to one of the parties does not necessarily render the contract contrary to the public interest," a "standard [that] is much more restrictive than the FPA's 'just and reasonable' standard." *Potomac Elec. Power Co.*, 210 F.3d at 407-08, 409-10.

The conflict between the Ninth Circuit decisions below and the decisions of the D.C. and First Circuits warrants this Court's review. Indeed, because the Federal Power Act, 16 U.S.C. § 825l(b), Pet. App. 394a-395a, permits parties to seek review of FERC orders in the D.C. Circuit, the conflict between the D.C. Circuit and the Ninth Circuit creates an incentive for parties seeking to enforce a contract to petition the D.C. Circuit for review, whereas parties seeking to undo a contract will choose the Ninth Circuit whenever possible. This Court should grant review to correct the untenable conflict in circuits created by the decision below.

II. THE NINTH CIRCUIT'S DECISION CREATES SUBSTANTIAL UNCERTAINTY IN THE NATIONAL ENERGY MARKETS AND REQUIRES IMMEDIATE REVIEW

A. The Ninth Circuit Has Made It Impossible For Sellers To Predict When Their Contracts Will Qualify For *Mobile-Sierra* Review

The immediate damage that the Ninth Circuit decision has inflicted on electricity markets cannot await a remand, further FERC decisions, and related appeals. Under *Mobile* and *Sierra*, a seller can limit the likelihood that its contractual obligations will be modified by subsequent government fiat. To obtain the certainty provided by "public interest" review, a seller need only: (1) sign a contract that fixes the price without an express right to modification; (2) avoid conduct that would be deemed fraud, duress, or bad faith; and (3) satisfy FERC's initial filing requirements. The seller can then make critical business decisions based on the

greater certainty and enforceability of contracts provided by the *Mobile-Sierra* doctrine.

The Ninth Circuit's decision makes it impossible for a seller to predict whether FERC will modify a valid contract during the contract's term. In *CPUC*, the Ninth Circuit held that FERC's initial opportunity to review a filed contract was not sufficient to trigger the public interest standard because FERC's original review "would have been hampered by limited information" and the "full scale of spot market manipulation and forward market dysfunction was not nearly as well known as it is today." Pet. App. 375a-376a. Thus, in future complaint cases, whether the public interest standard applies will depend on a subsequent determination of the adequacy of FERC's initial review.

Moreover, the *post hoc* agency review required by the Ninth Circuit turns on a factor entirely beyond the seller's control, *i.e.*, whether the market was in some way "dysfunctional" when the contract was originally entered into. Pet. App. 57a (asserting that *Mobile-Sierra* cannot apply without a determination that the challenged contract was formed "free from the influence" of "an otherwise dysfunctional market"). Notwithstanding a lack of unfairness, bad faith, or duress in the original negotiations of a challenged contract, the sanctity of the contract depends, in the Ninth Circuit's view, on the market "context," not the conduct of the sellers. Pet. App. 59a. If the Ninth Circuit's new rule stands, a sophisticated seller executing contracts in good faith with sophisticated buyers, and fulfilling FERC's initial filing rules, will not be able to rely on its contracts when making business and investment decisions.

B. The Decision Below Will Have Widespread And Harmful Effects On Wholesale Energy Markets

The decision below will adversely affect this Nation's electricity markets. Not only will FERC's review of wholesale power contracts be subject to different review

standards depending on the circuit in which an appeal is pursued, but the Ninth Circuit's ruling will severely undermine the "integrity of contracts" and the "stability of supplies" in electricity markets. As this Court has recognized, retrospective revisions to negotiated contracts will discourage investments needed to serve the Nation's electricity needs. *Mobile*, 350 U.S. at 344.

The decision below also will invite widespread litigation whenever market prices decline from temporarily high levels—a common pattern that reflects the interaction of supply and demand. The Nevada Companies alone sought to abrogate or amend two hundred contracts in the proceedings below. Pet. App. 30a. By diminishing the enforceability of contracts upon which functioning markets depend, the Ninth Circuit's decision will necessarily render markets less viable.

The impact of the Ninth Circuit's new paradigm on wholesale markets is widespread. For over a decade, FERC has expanded the scope of competitive markets built on open-access transmission that gives buyers access to many competing sellers and prevents sellers from exercising market power. Sellers that demonstrate their lack of market power are authorized to sell electric power at market-based rates, subject to compliance with FERC's regulations governing the market-based rate authorization. Indeed, most wholesale power sales over the past decade have been contracted under this market-based regime. By FERC's recent count, market-based tariffs have been approved for approximately 1150 companies: 550 independent marketers and generators with generating capacity less than 500 MW, and 600 other companies with more substantial generation, which includes traditional public utilities such as the Nevada Companies. *Market-Based Rates for Wholesale Sales of Electric Energy Capacity, and Ancillary Serv. by Pub. Util.*, Notice Proposed Rulemaking, FERC Stats. & Regs. ¶ 32,602, at 15-16 (2006).

Based on contractual commitments from buyers, sellers of electric power make corresponding commitments to enable them to generate the power that they have contracted to provide. The substantial commitments that sellers undertake in reliance on their contracts may include building or operating generation facilities; contracting to buy firm power from other sellers; purchasing generating fuel; purchasing transmission services; and hedging electricity costs through futures, options, or financial instruments (*e.g.*, derivatives or swaps).

The Ninth Circuit's rule, which authorizes ready modification of wholesale contacts, may trigger credit calls, early terminations of related agreements, loan defaults, and, in extreme circumstances, bankruptcy and service interruptions. Further, if contracts are perpetually subject to an unknowable risk of cancellation or modification, few, if any, sellers will choose to invest in the facilities, supplies, and financial arrangements needed to support the Nation's energy markets.

Finally, the Ninth Circuit's decision biases FERC rate regulation against sellers, allowing buyers to cherry-pick contracts and to shift losses to sellers. Challenges to contracts that are favorable to a buyer (so-called "low rate" contracts) would be reviewed under the *Mobile-Sierra* public interest test, while contracts favorable to seller (so-called "high rate" contracts) would be reviewed under the "just and reasonable" test. This sort of "seller-always-loses" scheme adversely impacts any incentive for investments in new electric generation.

C. The Facts Of This Case Demonstrate The Pervasive And Harmful Effects That The Ninth Circuit's Decision Will Have On The Nation's Wholesale Energy Markets

Applying the Ninth Circuit's framework to the facts of this case demonstrates that the decision will have pervasive

and harmful effects on the Nation's wholesale power markets by rejecting valid, arms-length transactions. A fundamental premise of the Ninth Circuit's decision is that, because the prices in the challenged contracts were high, they cannot be just and reasonable. Pet. App. 52a ("[W]hat actually happened during the California energy crisis" and the fact that FERC still permitted sellers to sell at market-based rates "undercut[] FERC's assertion that initial just and reasonable review occurred with respect to the challenged contracts"). But those contracts were negotiated by sophisticated parties that were operating under identical market conditions—conditions that were beyond either party's control, yet within each party's understanding.

Indeed, the Ninth Circuit misunderstands the role that marketers play in wholesale power markets. Power marketers are middle-men, meeting their sales obligations by buying power in the same, potentially "dysfunctional" markets as the Respondents. The Petitioners here did not cause the "dysfunction" in the California spot markets. Both buyers and sellers were making decisions in response to the same market dynamics. Absent unfairness, bad faith, or duress by the sellers in the original negotiations, there is no reason to blame these sellers for the market characteristics in force at the time of contracting.

Moreover, as FERC found below, the Nevada Companies were active buyers and sellers in wholesale markets, not mere retail providers. The Nevada Companies made a business decision to purchase electricity for parts of three future years, in quantities in excess of their retail requirements. Pet. App. 297a. Like other energy traders, the Nevada Companies bought power on a discretionary basis in the hopes of reselling it for a profit, as they had done in the recent past (to the tune of $100 million during 2000). Pet. App. 154a.

When entering the contracts in question, the Nevada Companies chose among many offers and potential sellers, including offers for lower prices than they accepted. Pet. App. 297a-298a. They solicited bids through an independent broker and contracted with sellers of their choosing. They were not captive customers. FERC found that Petitioners—not Respondents—were "price takers," Pet. App. 160a, 297a, which means that Petitioners "took the price the market yielded rather than bargaining or demanding certain prices." Pet. App. 30a. Because the Nevada Companies failed to hedge their costs or to immediately resell power, and faced losses when market prices fell for the periods covered by the contracts, they sought to escape their "improvident bargains" by unilaterally seeking to amend the contracts by filing complaints at FERC. Pet. App. 301a.

In effect, the Nevada Companies—with the Ninth Circuit's approval—seek to shift to others, by FERC action, a "low return" that they had contractually agreed to incur. As this Court explained in *Sierra,* sophisticated market participants like Respondents may "agree by contract to a rate affording less than a fair return," and are not "entitled" under the FPA "to be relieved of its improvident bargain." 350 U.S. at 355.

Finally, under *Mobile* and *Sierra*, the issue is not whether market conditions or market "dysfunctions" affected contracting. There is simply no basis to blame these sellers, and to protect the Nevada Companies from their resale losses, when these sellers executed the contracts in good faith. Overturning FERC's decision to respect contract sanctity in this case exacerbates the harmful effects of the Ninth Circuit's order on the national energy markets.

III. THE DECISION BELOW ERRONEOUSLY AND NEEDLESSLY CASTS ASIDE THE *MOBILE-SIERRA* REGIME

The decision below erroneously casts aside the *Mobile-Sierra* regime. The Ninth Circuit's decision needlessly requires FERC plenary review as a prerequisite to application of the public interest standard and unjustifiably mandates different treatment for low-rate and high-rate challenges to contracts.

A. The Ninth Circuit Erroneously Required Initial Plenary Review As A Prerequisite To Application Of The Public Interest Standard

The Ninth Circuit held that FERC must, before applying the *Mobile-Sierra* doctrine, determine that the rates in the challenged contracts were "in fact 'just and reasonable,'" and must undertake an "inquiry into the actual state of the market at the time the contracts were negotiated." Pet. App. 51a. Requiring this plenary review of contract rates is contrary to the flexible initial review scheme enacted in the FPA, and is inconsistent with *Mobile* and *Sierra*.

The FPA presumes that rates set by valid contracts are just and reasonable and must be enforced except in extraordinary circumstances. That presumption does not depend on initial prior review of the contract, as the Ninth Circuit held. Instead, it derives from Congress's recognition that, in the context of wholesale electricity markets, privately negotiated rates will generally be "just and reasonable" because "the party charging the rate and the party charged [are] often sophisticated businesses enjoying presumptively equal bargaining power." *Verizon*, 535 U.S. at 479. Thus, in reviewing contract rates under the FPA, FERC's "principal regulatory responsibility" is "not to relieve a contracting party of an unreasonable rate, but to protect against potential discrimination by favorable contract rates between allied businesses to the detriment of other wholesale

customers." *Id.* (internal citations omitted); *see also Pub. Serv. Comm'n v. Fed. Power Comm'n*, 543 F.2d 757, 797 (D.C. Cir. 1974) ("Th[e] test . . . is not whether a contractual provision seems to be equitable to the contracting parties but whether it is detrimental to the public interest."). Accordingly, the *Mobile-Sierra* doctrine is premised upon the critical role of contractual arrangements in the regulatory scheme, not upon the opportunity for, or the scope of, FERC's initial review.

Although the contracts at issue in *Mobile* and *Sierra* were filed with the agency and allowed to take effect, this Court never suggested that the applicability of the public interest standard turned on the fact or scope of the Commission's initial review. In fact, the Federal Power Commission, FERC's predecessor, merely accepted for filing the contract rate in the *Mobile* case. For decades before the advent of market-based rates, the FPC/FERC typically "accepted for filing" submissions of individual contracts without any ruling on their justness and reasonableness.

The Court explained in *Mobile* that "the ratemaking powers" of utilities are "no different from those they would possess in the absence of the Act," except that "the contracts remain fully subject to the paramount power of the Commission to modify them when necessary in the public interest." *Mobile*, 350 U.S. at 344. In *Sierra*, even had the Commission concluded on an initial review that the contract rate afforded the utility "less than a fair rate of return," the agency has no authority to "relieve[]" the utility "of its improvident bargain." *Sierra*, 350 U.S. at 355. Except in extraordinary circumstances where upholding a wholesale electricity contract will adversely affect the public interest, FERC has no power under the statute to abrogate or modify the contract. *See Ark. La. Gas Co.*, 453 U.S. at 581 ("[T]he Commission itself lacks affirmative authority, absent extraordinary circumstances, to 'abrogate existing

contractual arrangements.'") (quoting *Permian Basin*, 390 U.S. at 820).

Finally, the Ninth Circuit's approach is unnecessary because FERC's pre-existing market-based regime constitutes an effective initial review of rates. Under FERC's existing approach, wholesale sellers are free to negotiate rates for sales to willing buyers so long as the sellers demonstrate that they lack market power. The D.C. Circuit has repeatedly held that this approach comports with the FPA. *See, e.g.*, *Elizabethtown Gas Co.*, 10 F.3d at 870-71. FERC also had in place in 2001 (as it does today) mechanisms to ensure that the market remains competitive after FERC grants market-based rate authority. Sellers had to file quarterly reports summarizing all market transactions. Every three years, sellers had to submit to a full market-power analysis. Respondents could have filed a complaint under Section 206 of the FPA seeking revocation of Petitioners' market-based rate authority *before* or immediately after they executed the challenged contracts. Under the Ninth Circuit's new approach, however, no initial review could have been sufficient. Pet. App. 375a-376a.

B. The Ninth Circuit's Public Interest Standard For High-Rate Challenges Is Erroneous and Unjustified

The Ninth Circuit ruled that FERC erred "in the substantive standard it used in determining that the contracts at issue did not affect the public interest." Pet. App. 3a. The court of appeals held that the factors identified by this Court in *Sierra* apply only in "the context of a *low-rate* challenge." Pet. App. 61a. In a *high-rate* challenge such as this case, it declared that "the key 'public interest' . . . is assuring that the consuming public pays fair rates," Pet. App. 63a, which requires FERC to determine whether the contract rates fall outside the "zone of reasonableness." *Id.* This holding ignores the teachings of *Mobile* and *Sierra*, is entirely

unjustified, and fundamentally usurps FERC's policymaking responsibilities.

This Court has adopted the fundamental principle that "the Commission [is] without authority to abrogate existing contract prices unless it first conclude[s] that they 'adversely affect the public interest.'" *Permian Basin Area Rate Cases*, 390 U.S. at 821. This Court recognized that restricting the agency's power to modify valid contracts is essential to achieve Congress's goal of ensuring a stable and sufficient supply of electric power. *See Mobile*, 350 U.S. at 344. But the Ninth Circuit required abrogation of any "unreasonable" contract rates, regardless of the long-term consequences for electricity markets and consumers. The Ninth Circuit's holding that buyers may undo the terms of their voluntarily negotiated contracts simply by showing that contract rates would exceed the "*just and reasonable range*," Pet. App. 64a(emphasis added), provides sellers no greater protection than if there were no contract at all.

In *Sierra*, this Court refused to permit FERC to "relieve[]" a seller "of its improvident bargain." *Sierra*, 350 U.S. at 355. The Court's reasoning applies equally to buyers. As the First Circuit explained, it is "logically inferable" that both sellers and "purchasers can make bargains which in hindsight prove improvident." *Boston Edison Co. v. FERC*, 856 F.2d 361, 372 (1st Cir. 1988). The FPA contains no special contractual protections for buyers, and the Ninth Circuit's construction of the statute to grant buyers more favorable post-contract remedies destroys the "symmetry to the ratemaking process." *Id.* Under the Ninth Circuit's holding, a buyer can obtain a rate modification if it can demonstrate that "a challenged contract imposes any significant cost on ultimate consumers because of a wholesale rate too high to be within a zone of reasonableness," Pet. App. 63a, but sellers can only seek relief from the contract rates if those rates "impair the financial ability of the public utility to continue its service,

cast upon other consumers an excessive burden, or be unduly discriminatory," *Sierra*, 350 U.S. at 355. That disparate result cannot be reconciled with the goal of "preserving contract stability," and will not "permit[s] the stability of supply arrangements which all agree is essential." *Mobile*, 350 U.S. at 344.

CONCLUSION

For the foregoing reasons, the petition should be granted.

Respectfully submitted,

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